economic trends

November 2013

Population surges as strong expansion continues

This edition of Trends is taken from the Second Quarter Fiscal Update and Economic Statement, released on November 26, 2013. The inFocus explores why global economic growth has failed to live up to expectations.

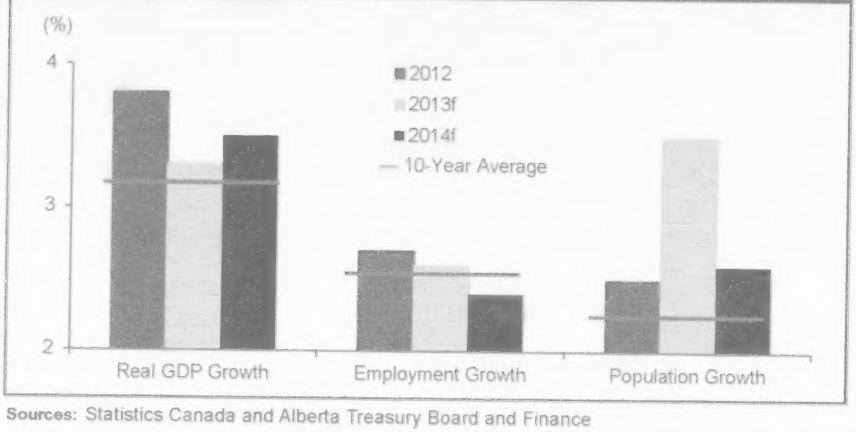
The Alberta economy continues to charge ahead, with few signs of slowing in the short term. The province is set to be among Canada's growth leaders again in 2013. Real GDP is now expected to expand by 3.3% this year (Figure 1), up from the forecast at First Quarter and Budget 2013. This comes after Alberta led all provinces in employment and real GDP growth in 2011 and 2012. Economic growth for 2014 has also been revised up since Budget 2013 to 3.5%, mainly reflecting flood reconstruction activity.

The oil sector remains a key driver, with high levels of investment and large increases in production supporting economic growth.

A thriving labour market has lured people to Alberta in droves; 105,200 net migrants landed in Alberta during census year 2013. This has spurred construction and consumer spending, while keeping wage growth contained.

Another key development has been the flooding in southern Alberta. The floods resulted in extensive property damage, as well as supply disruptions in June and July. However, in terms of economic activity, spending on reconstruction is expected to boost employment, wages and real GDP in 2013 through 2015.

Figure 1. Forecast for Alberta Indicators



Sources: Statistics Canada and Alberta Treasury Board and Finance

Alberta Household Sector

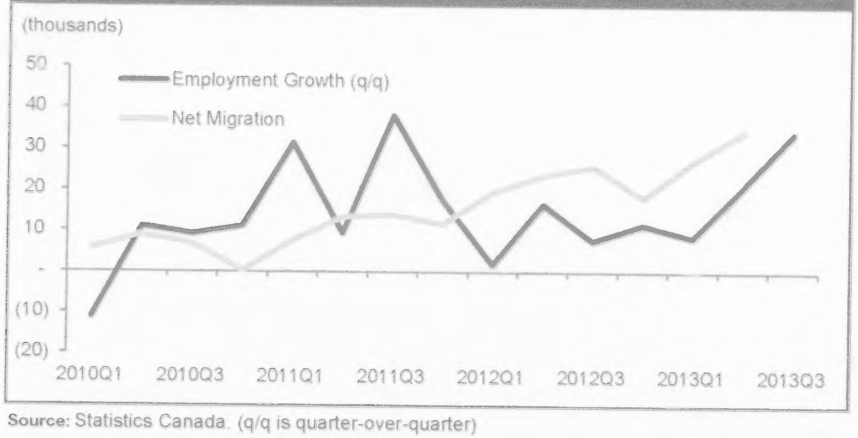
Population leaps past 4 million

Alberta is now home to over 4 million people, thanks to a 3.5% jump in the population during the census year ending July 1, 2013. The province has not seen growth of this magnitude since 1981. In 2014, the population is expected to expand at a solid, albeit more moderate, pace of 2.6%.

Job growth picks up, labour market stays balanced

Job opportunities have attracted people to Alberta. Employment growth has been stronger-than-expected, and is now forecast at 2.6% in 2013, roughly matching last year's pace. Growth accelerated in the third quarter of 2013, with 33,800 jobs added. Normally job growth of this magnitude would result in a large dip in the unemployment rate; however, the surge in population has helped keep the labour market balanced (Figure 2). The unemployment rate has stayed in the 4.3% to 5.0% range this year, and job vacancies have held fairly steady. Likewise, pressure on weekly earnings have been contained. The forecast for primary household income, a driver of personal income tax revenues, is roughly unchanged from the

Figure 2. Alberta Employment Growth and Net Migration



Source: Statistics Canada. (q/q is quarter-over-quarter)

First Quarter at 6.0%; however, it is up from the Budget 2013 forecast of 5.4% on stronger-than-expected job growth.

Housing bucks national trend

Alberta is on pace to see another increase in residential investment in 2013 and again in 2014. The housing market has tightened this year, with the sales-to-new listing ratio rising, and the number of new unoccupied homes trending lower. New migrants and the Alberta floods have buoyed housing demand and allowed Alberta to buck the national slowing trend in housing.

Consumers in the drivers seat

Spending by households accounted for about a third of Alberta's economic growth last year. Households will make another solid contribution this year, thanks to record in-migration and a strong labour market. Real consumer spending is forecast to increase by 4.9% in 2013 and by 4.1% in 2014. A major contributor has been vehicle purchases. Historically volatile, vehicle sales have been persistently strong in Alberta. Some of the recent strength is likely due to flood-damaged vehicles being replaced. Consumers are spending in a low inflation environment; inflation has averaged only 1.4% so far this year.

Alberta Business Sector

Oil price forecast revised higher

World oil prices increased markedly over the summer due to Middle East tensions, particularly in Syria. While an easing of tensions has caused prices to retreat, the North American oil price (WTI) has remained above levels forecast at Budget 2013. Moreover, additional pipeline capacity between Cushing, OK and the US Gulf Coast has reduced the gap between the world Brent price and WTI since early 2013. As a result, the WTI forecast has been upgraded to US$98.96/bbl for this fiscal year. The differential between Alberta's heavy oil benchmark, Western Canada Select (WCS), and WTI remains highly volatile due to a lack of spare transportation capacity.

Loonie dips

The Canadian dollar has weakened against the US dollar since early 2013. Stronger US economic news has raised expectations that the Federal Reserve will taper its Quantitative Easing program. Meanwhile, the Bank of Canada has signalled a softer stance on interest rate increases. Both developments have contributed to the Canadian dollar weakening and a lower exchange rate forecast of US¢97.5/CDN$ for 2013-14.

Exports rebound

Stronger oil prices over the summer have provided a boost to the value of Alberta's international exports. Energy exports, which comprise about two-thirds of Alberta's total, jumped 17% in the third quarter of 2013 over the same time last year. Higher prices have also lifted Alberta's manufacturing shipments, notably sales of refined petroleum products.

Production has also resumed after a series of supply disruptions in the spring, including refinery maintenance shutdowns and delays at oilsands facilities. Oil exports were disrupted by flooding in June, but have since bounced back. Amid ongoing pipeline constraints, an increasing amount of oil is now transported by rail. In the agriculture sector, growing conditions have been favourable, with production on pace to hit a new record in 2013 for a number of crops, including wheat and canola. Exports will remain a key driver of Alberta's economic growth in 2014, as bitumen production continues to ramp up.

Flood reconstruction having an impact

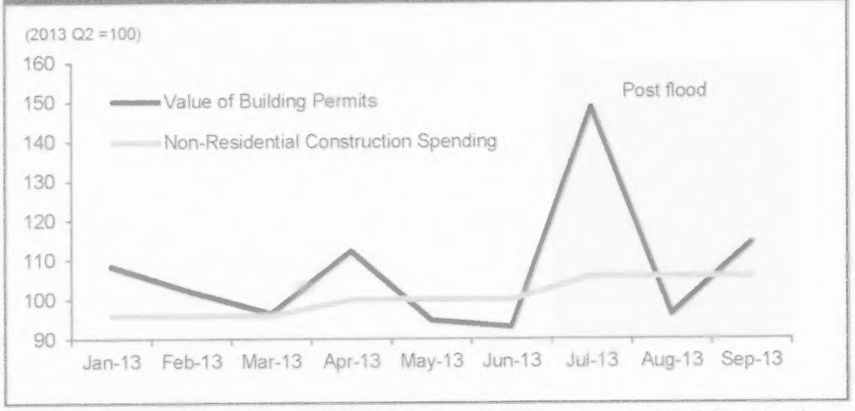
Reconstruction is lifting building activity. Calgary's building permits spiked the month after the flood (Figure 3), and non-residential construction accelerated in the third quarter. Flood reconstruction is expected to add to Alberta's economic growth in 2014 before gradually tapering in 2015 and beyond. With permits up 20% in the first three quarters of 2013, strong construction activity is expected to continue.

External Risks

Global economic conditions remain weak (see InFocus). Alberta's outlook is subject to a number of external risks:

- With a lack of spare pipeline capacity, small transportation and refinery disruptions can result in large swings in the price of oil produced in Alberta.
- A further slowdown of emerging market economies would weigh on global demand and oil prices.
- Stronger-than-expected US economic growth remains the main upside risk to the forecast.
- A further drop in the Canadian dollar could provide a further boost to the value of Alberta exports.

Figure 3. Construction indicators for Calgary*



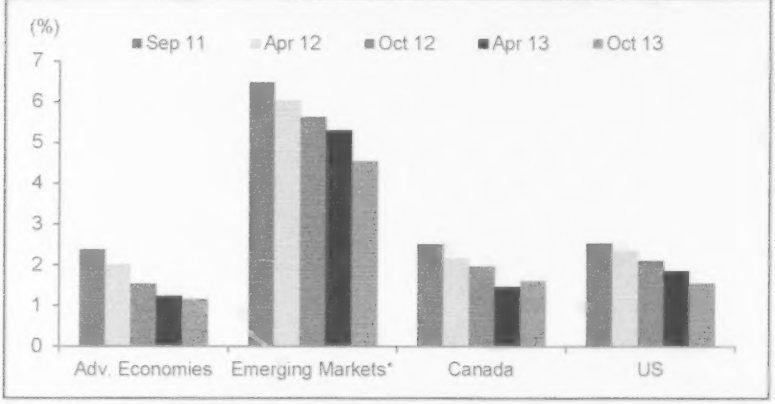
Sources: Statistics Canada, Alberta Treasury Board and Finance. *Non-residential construction spending is quarterly data. Both series are seasonally adjusted.

The global recovery forever on the horizon

Global growth in the wake of the 2008-09 recession has failed to live up to expectations. In October, the International Monetary Fund (IMF) downgraded its 2013 forecast for the sixth consecutive time (Figure 1). Recent weakness has originated from emerging markets, where growth has slowed, as well as a stagnant Eurozone economy.

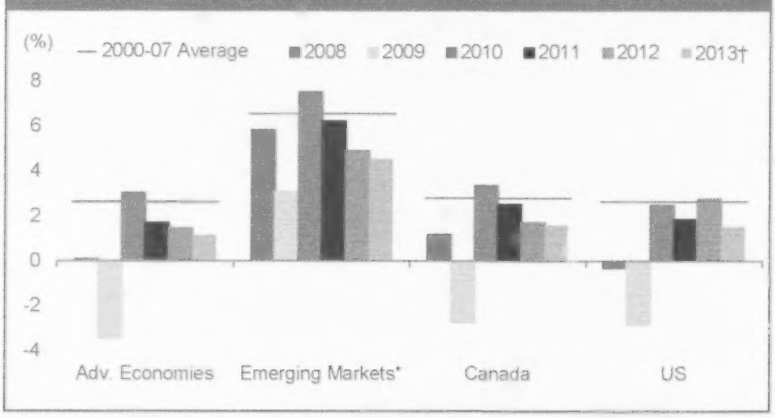
The IMF is not alone in downgrading its forecast. Many forecasters have repeatedly predicted growth to return to pre-crisis levels only to be disappointed when growth fails to meet expectations. For most economies, growth since 2010 has been well below the 2000-07 average and is trending downward (Figure 2). One possibility is that conditions are not as favourable as they once were, and forecasters have not adjusted to the new reality. A second possibility is that forecasters were correct to expect a rebound, but have not got the timing right. The slack in the economy cannot last forever, and when it is finally taken up, the long-predicted rebound in growth will occur. Both of these possibilities are explored below.

FIGURE 1. 2013 Real GDP Growth Forecast by Date



Source: International Monetary Fund

FIGURE 2. Real GDP Growth



Source: International Monetary Fund

Emerging market growth downshifts

Emerging markets, both before and since the recession, have been drivers the global economy. However, growth in these economies has been weakening and may never again reach the lofty levels achieved in the 1990s and early 2000s. This may be a blessing in disguise. Emerging markets were able to achieve such high growth because they were in the early phase of development and had so much to gain. As their economies developed, additional gains were harder to achieve.

China, for example, averaged 10.7% annual growth between 1991 and 2007. In each year since, growth has fallen below this mark, falling to a 13 year low of 7.8% in 2012. China was able to achieve such high rates of growth through urbanization, improved educational attainment and massive capital investment. Each of these factors is subject to diminishing returns, which may have contributed to the slower growth of late. Moreover, in the face of weak demand in advanced economies, Chinese growth has rotated away from exports and investment, and towards domestic consumption. This rebalancing has hurt overall growth in emerging markets, but provides the global economy with a much-needed source of demand going forward.

Baby boomers are exiting the labour force

Advanced economies have benefited from an expanding labour force made possible by greater labour force participation among women and by baby boomers reaching their prime working years. The participation rate,

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the share of the working-age population employed or actively seeking work, rose as a result, allowing for more growth than if the rate was unchanged. Going forward, the participation rate for women will not contribute as much to growth, as it has largely converged to that of men. Moreover, now that baby boomers are beginning to retire, a major source for growth will start to detract from it.

This trend is unfolding in the U.S. The participation rate has been declining since 2000, recently falling to a 30-year low (see Figure 3). A lower participation rate helps explain why the employment-to-population ratio has barely budged despite the unemployment rate falling 2.7 percentage point from its recessionary peak. More people are working, but the labour force makes up a smaller share of the total population.

Aging is does not fully explain the drop in the US participation rate. The recession induced many to leave the labour force. These people will likely return as conditions improve. However, increasing labour force participation can no longer be counted on to deliver growth like it did in the past.

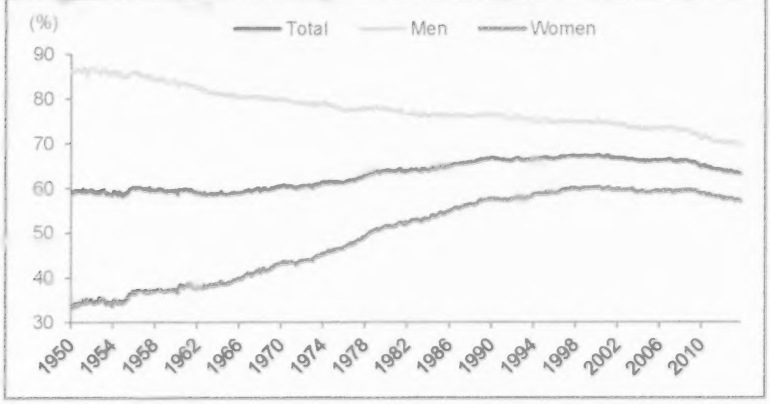
Cyclical factors matter too

Not all the weakness in global growth is due to structural changes. The importance of the economic cycle is highlighted by inflation, which has declined steadily throughout most of the advanced world since 2011. Weak price growth is a symptom of weak demand, the return of which would increase both output growth and inflation.

In the latest data, year-over-year inflation was 1.1% in Canada, 0.9% in the U.S. and 0.7% in the Euro Area. In Canada's case, inflation has trended downwards since May 2011, and has been below the Bank of Canada's 2% inflation target since April 2012. Over this period, the Bank's inflation forecasts have been repeatedly revised down (Figure 4).

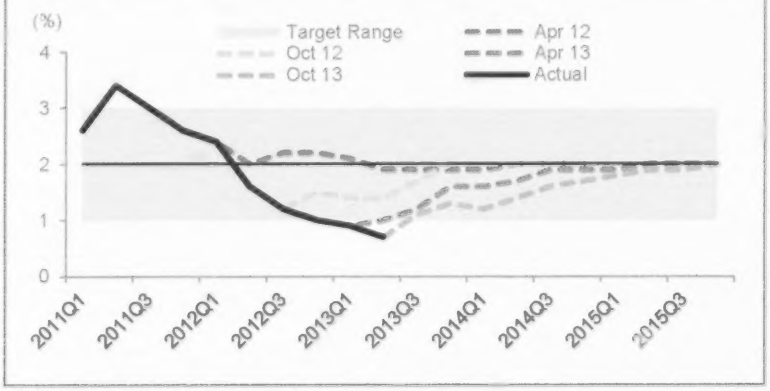
No country has struggled with deflation and weak growth more than Japan for much of the last 20 years. Nevertheless, Japan is one of few advanced economies where inflation has been increasing, thanks to aggressive policy actions. Over the last year, Japan has undertaken unprecedented monetary stimulus supported by stepped-up fiscal stimulus. Though still only 1.0%, Japanese inflation has jumped 1.9 percentage points since March. The added stimulus has also impacted real GDP growth, which has averaged 3.3% (annualized) over the first three quarters of 2013. Japan is one of few countries for which the IMF has increased its 2013 growth forecast.

Figure 3, US Labour Force Participation Rate



Source: US Bureau of Labor Statistics

Figure 4. Bank of Canada Inflation Forecasts



Source: Bank of Canada

Conclusion

The global economy has been slow to come out of the 2008-09 recession. Elevated unemployment and low inflation are evidence of weak demand. When demand improves, so too will growth. However, some of the engines of growth during the past 50 years have been running out of steam. China cannot sustain double-digit growth indefinitely, and the baby boomers are leaving the labour force in growing numbers. Unless new sources of growth emerge, growth will likely be lower than in the past.

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